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Re: California Landscape Contractors Association Opposition to Business Net Receipts Tax

Dear Commissioners & Staff:

The California Landscape Contractors Association (CLCA) respectfully urges the Commission not to include a Business Net Receipts Tax (BNRT) as part of its comprehensive tax reform recommendations to be submitted to the Governor and Legislature on September 20. We believe a BNRT would have significant adverse effects on California's small landscape construction and maintenance contractors and do particular harm to the landscaping industry by driving more of our work to the untaxed underground economy.

CLCA is a trade association representing more than 3,000 licensed landscape contractors and affiliated businesses that design, install, and maintain commercial, residential, and public landscapes throughout California. Our membership runs the gamut from very large firms with hundreds of employees to one-person firms with no employees. The association's 2008 Compensation and Personnel Practices Survey indicated that 63 percent of our members had fewer than 20 employees. Approximately 48 percent of landscape contractors had gross annual sales of less than \$500,000. Based on these data we would expect about half of CLCA members to be subject to the BNRT if the proposal contains an exemption for small businesses with gross receipts of less than \$500,000. Should the Commission opt for a \$250,000 exemption, we estimate the tax would capture roughly two-thirds of our membership.

Our most serious concern with a BNRT is its enormous potential to shift landscaping work to the unlicensed underground economy. So far as we know, the Commission and its staff have given scant consideration to the extent to which a BNRT would provide new reasons for persons to exit legitimate businesses and make their living in the underground economy. Lost revenue from California's underground economy already exceeds \$6.5 billion annually according to the Office of the Legislative Analyst.¹ Adding a new tax on business services will only make it more appealing for businesses to go underground where they can undercut legitimate businesses by the avoidance of taxes, wage and hours laws, and worker safety regulations. While CLCA recognizes that a BNRT is intended to reduce revenue volatility and achieve other theoretically beneficial fiscal policies, the tax's real world effects on California small businesses – especially those in the service sector – could be devastating. We would also note that any tradeoff benefits from lower sales tax rates would actually help unlicensed landscape contractors because a sales tax on landscaping materials, unlike a percentage tax on net receipts, is difficult for underground operators to avoid.

There are many other practical problems with a BNRT for businesses engaged in construction and maintenance services. They include:

- As other commentators have pointed out, a BNRT without an exemption for employee compensation is effectively a tax on labor. Instead of hiring employees directly on its payroll, the tax would encourage landscape contractors to subcontract

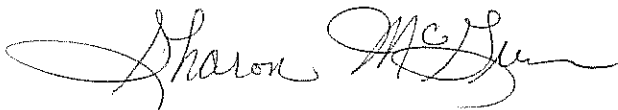
¹ Office of the Legislative Analyst, *California's Tax Gap*, February 2005.

work or hire temporary labor, both of which are deductible expenses for calculating net receipts subject to the tax. Such workers are likely to be paid lower wages, have fewer or no fringe benefits, and be less skilled and reliable. Taxing labor at a time when the state is experiencing double digit unemployment simply makes no sense.

- Under a BNRT, employers would be incentivized to downsize their businesses to avoid the tax. For example, what is to prevent a business from dividing itself into multiple smaller companies, each of which has gross receipts under the threshold that triggers the tax?
- A BNRT would impose significant new tax compliance costs on landscaping businesses. As mentioned above, we expect at least half of landscape contractors to be subject to the tax. Each contractor would need to spend additional amounts on accountants and bookkeeping staff in order to determine what expenses are deductible from gross receipts.
- A BNRT appears to be easy to manipulate because the taxpayer can time its purchase of inventory, capital equipment, and materials to reduce the tax. This characteristic seems to inject more tax complexity and raises questions of fairness as more savvy and profitable businesses seek to minimize their taxes while smaller, less sophisticated businesses without access to lawyers and accountants will pay full freight.
- Finally, we note that a BNRT would be levied even if a landscaping business ended the year with no profit or a net loss. Ironically, a business that tried to do the right thing by retaining rather than laying off employees in an economic downturn is more likely to be punished under the current proposal.

In summary, it is difficult for CLCA members to see how the proposed BNRT could do anything but damage California's landscape contractors as well as the broader "green industry," which is composed of all the people and businesses in our state that build, grow, install, sell, and maintain landscaping infrastructure. This industry has a \$22.9 billion annual economic impact and employs 296,000 Californians. Putting these businesses and jobs at risk by imposing a business net receipts tax would be a dangerous risk even when considered in light of other needed reforms to reduce income, sales, and corporate income taxes. We therefore urge the Commission in the strongest possible terms not to include a BNRT in its final recommendations.

Sincerely yours,



SHARON MCGUIRE
Executive Director

cc: Governor Arnold Schwarzenegger
Senator Darrell Steinberg
Assemblymember Karen Bass
Senator Dennis Hollingsworth
Assemblymember Sam Blakeslee
Marty Keller, Director, California Office of Small Business Advocate
Heath Bedal, President, CLCA
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